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SUBJECT: VIETNAM'S ECONOMY IN 2004: HIGH GROWTH, INFLATION AND EXPORTS

¶1. Summary: The Vietnamese economy achieved a growth rate of 7.7 percent in 2004. Foreign direct investment and exports recorded the highest growth rates in the last seven years (37 percent and 28.9 percent respectively). Nonetheless, the economy is faced with increasing inflation primarily resulting from external factors with the Consumer Price Index rising 9.5 percent. End Summary.

GENERAL ECONOMIC PERFORMANCE

¶2. Vietnam's real Gross Domestic Product (GDP) grew at 7.7 percent in 2004, surpassing that of 2003 (7.24 percent) and ranking among the highest in the region. Vietnam's economy achieved this high growth rate despite adverse weather conditions, the avian influenza and higher prices of raw materials.

¶3. The agriculture, forestry and fishery sector grew by 3.5 percent, at the same rate as last year. Agriculture grew at only 2.9 percent due to unfavorable weather conditions just as the winter-spring crop began. Moreover, the avian influenza outbreak led to significant poultry losses. The massive culling of poultry in early 2004 caused the loss of 15 percent of the country's total poultry stock. The industry and construction sector was comparable to last year's at 10.2 percent. The services sector grew by 7.5 percent, surpassing its 6.4 percent average growth from 2001-
¶2003.

¶4. The Consumer Price Index (CPI) rose sharply by 9.5 percent compared to 2003. Prices for food and foodstuffs, which account for 47.9 percent of the price basket, were the main contributors to the rising CPI. Other items also rose: pharmaceuticals and medical services (up 13.9 percent) and housing and building materials (up 6.4 percent). Higher world oil prices also contributed to the CPI as transportation and postal services account for 10 percent of the price basket and petroleum price fluctuation affected the prices of almost all other goods and services.

¶5. In an effort to curb inflation, the State Bank of Vietnam (SBV) raised the compulsory reserve ratio to control credit growth and limit money supply. The IMF welcomed this timely action to counter inflation. As a result the CPI increased at a slower pace in the second half of 2004. The CPI increased 1.1 percent in January and 2.5 percent in February. Food and foodstuffs remain the driver of the price index. Medicine prices rose as much as 20 percent. With prices of raw materials for production fluctuating unpredictably on local and world markets in 2005 and the return of avian influenza, Vietnam may have difficulty keeping its CPI below its target of 6.5 percent.

¶6. Remittances by overseas Vietnamese residents and Vietnamese workers abroad have been rising steadily. State Bank officials estimated the total inward remittances through the banking system to be at USD 3 billion in 2004, surpassing the record figure USD 2.5 billion in 2003.

FOREIGN DIRECT INVESTMENT

¶7. Foreign Direct Investment (FDI) was a bright spot in Vietnam's 2004 economic performance. There was USD 2.1 billion worth of new FDI commitments, a 37 percent year-on-year increase and the highest level since the Asian Financial Crisis in 1997-1998. The average registered capital per project rose to USD 3.1 million in 2004 from USD 2.5 million in 2003. In addition to USD 2.1 billion worth of FDI registered in 679 new projects, about USD 2 billion went to more than 400 existing operating projects. Most new FDI was still in the industry sector with 431 projects and USD 1.24 billion in capital. This accounted for nearly two-thirds of the number of new projects and about 60 percent of the total registered capital.

¶8. Most new foreign investment continues to flow to the southern region with 479 projects worth USD 1.34 billion, accounting for 70 percent of the number of new projects and 64 percent of the total annual registered capital. Dong Nai, Binh Duong, Ho Chi Minh City and Ba Ria-Vung Tau received the most FDI.

¶9. Taiwan was the largest foreign investor in Vietnam in 2004 with 142 projects worth USD 424.5 million, accounting for 20.4 percent of the total new registered capital. Following Taiwan were South Korea, Japan, the British Virgin Islands, Canada, Singapore, Hong Kong, Malaysia, China and the United States.

¶10. The Government has recognized the importance of foreign investment to economic growth and the increasing competition for foreign investment in the region. The Government is drafting a common investment law intended to create a level playing field for all companies doing business in Vietnam for submission to the National Assembly by fall of 2005. The Government is also drafting a proposal to decentralize state management in foreign investment. Under this proposal, Hanoi and Ho Chi Minh City would be given authority to grant licenses for foreign investment projects with capital up to USD 40 million. Other provinces and cities would be authorized to issue licenses for projects up to USD 20 million, except for projects subject to Prime Ministerial approval. (Note: The list of FDI projects subject to Prime Ministerial approval is included in Vietnam's Investment Climate Statement. End Note.)

TRADE

¶11. Exports were another bright spot in Vietnam's economic picture. Exports rose by 28.9 percent in value to USD 26 billion, the highest annual growth in the last seven years. Export growth continued at a high rate because world commodity prices rose, some products achieved a higher export value (e.g., coal, coffee, tea and pepper), and exports entered new markets in Africa, Latin America and Eastern Europe.

¶12. As a result of the continued rise in world oil prices, crude oil was the main contributor to export growth, generating USD 5.7 billion of income and recording 48.3 percent growth. Other significant contributors to export growth included electronics components, wood products, rice, coffee and rubber.

¶13. In addition to the four traditional key export products with export earnings above USD 2 billion (crude oil, textiles and garments, footwear and aquatic products), electronic components and wood products (furniture) emerged as new major exports. Electronics export earnings reached USD 1.08 billion in 2004, representing a surge of 60 percent over 2003. The export value of wood products soared to USD 1.05 billion, up 85.9 percent compared to the previous year. The United States, Japan, the United Kingdom, Germany, Taiwan and France were major markets for wood product exports.

¶14. Textile and garment exports continued to be strong with a value of USD 4.3 billion, representing 17.2 percent growth. The United States remains Vietnam's main market, accounting for 56 percent of Vietnam's export value. As exporters looked for new markets, textile exports to the European Union increased 32 percent over the 2003 level.

¶15. Other traditional export products such as rice, coffee, rubber and coal achieved significant growth as a result of rising world prices. Rice exports were up by 6.3 percent in volume but surged 30.6 percent in value due to improved quality and higher prices. Similarly, rubber exports rose 14.2 percent in volume, but soared 53.2 percent in value.

¶16. A new development in Vietnam's 2004 trade picture was the ranking change of its trading partners. China emerged as its second largest trading partner with USD 7.2 billion total trade value following the European Union with USD 7.4 billion. Vietnam's trade with China increased sharply by 47.6 percent. Vietnam's exports to China rose 59 percent while Vietnam's imports increased 43 percent. China's emergence moved Japan and the United States down to Vietnam's third and fourth largest trading partners with total trade values of USD 7 billion and USD 6.1 billion respectively.

¶17. Total imports to Vietnam were USD 31.5 billion, up 25 percent compared to last year. The domestic sector spent USD 20.5 billion (65 percent of total import value), up 25.2 percent from last year and Foreign-invested enterprises imported USD 11 billion (35 percent of total import value), up 24.4 percent from last year. Machinery, equipment and materials for production accounted for 94.6 percent of the total import value and increased 26.3 percent over last year. Consumer goods only comprised 5.4 percent of total import value and rose only 5.3 percent compared to the 2003 level.

¶18. Since Vietnam still depends on imported materials for its production, world price fluctuations affect both Vietnam's exports and imports. Rising prices of some products such as petroleum, steel, fertilizer, plastic and wheat flour caused the import value of these products to increase while import volumes rose modestly or even declined (for example, petroleum imports grew only 9.2 percent in volume but increased 46.8 percent in value, and fertiliser decreased 1.9 percent in volume but rose 30.3 percent in value).

¶19. Exports grew faster than imports. The trade deficit (USD

5.5 billion in 2004), as a percentage of total export value, was down to 21.2 percent from 25.7 percent in 2003.

¶20. According to United States International Trade Commission Data, Vietnam's exports to the United States continued to rise, generating USD 5.3 billion in 2004 (17.8 percent year-on-year growth). Vietnam's major exports to the United States were textiles and garments, footwear, aquatic products and wooden products (furniture). However Vietnam's imports from the United States declined slightly to USD 1.2 billion from USD 1.3 billion last year. Major U.S. exports to Vietnam included aircraft and parts, machinery and equipment, cotton and plastics. This resulted in Vietnam's widened trade surplus with the United States, to USD 4.1 billion in 2004. Note: The preliminary data of Vietnam's General Statistics Office, however, show slightly different figures: Vietnam's exports to the United States were USD 4.99 billion and Vietnam's imports from the United States were USD 1.13 billion. End note.

¶21. Comment: Vietnam's impressive growth rate continued in ¶2004. Largely due to avian influenza, inflation was the most formidable challenge, but did not dampen export-led growth. As Vietnam's economy continues to open to global markets, the problems facing policymakers are becoming more complex. There is no accurate understanding of how interest rate changes affect the banking system. The FDI rebound reflects the government's continued efforts to remove obstacles to foreign investors as well as investors' confidence in Vietnam's business environment. However, foreign investors continue to urge the Government to make its policies and rules more transparent, to improve infrastructure and to stop corruption.

MARINE